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Asset Management

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PHARMA/wHEALTH

First Half 2016

Note: The reporting below has been provided by and reflects the opinion of Pharma/wHealth Management Company S.A., Luxembourg

The first half of 2016 delivered negative results for the fund in a very volatile environment. Profit-taking in the sector in the first quarter, combined with negative political headlines were followed with a comeback in second quarter.

	2012	**2013**	**2014**	**2015**	**1H 2016**	**2Q 2016**
USD- R Units	18.25%	36.33%	19.12%	7.44%	-8.97%	+4.77%
USD-I Units	18.81%	37.07%	19.76%	8.01%	-8.74%	+4.91%
EUR-R Units (Hedged)	16.55%	34.28%	22.76%	10.40%	-9.97%	+4.73%

Since inception nearly 23 years ago, Pharma/wHealth has delivered a compounded annual growth rate (CAGR) of around 10.5% net to investors after all fund expenses. A USD 10,000 investment at inception of Pharma/wHealth is now worth USD 89,000.Please keep in mind that long-term historical outperformance of the S&P 500 (about 3% per year) and the MSCI World Healthcare Index (about 2% per year) is no guarantee of future results.

			Previous Six Years	
	2015 Year End	**30 June 2016**	**High**	**Low**
Biotech	23%	24%	40%	14%
Pharma	24%	21%	36%	11%
Medtech	16%	14%	22%	13%
Generics (1)	20%	20%	24%	13%
Healthcare Services	17%	21%	21%	8%

(1) Generics in the portfolio reflect mostly emerging markets companies.

The biggest changes during the first half of 2016 was the reallocation from the bigger pharmas and medtech to healthcare services (4%) and biotech (1%). The switches were driven by profit taking. The healthcare service providers, which includes the insurance companies and the benefit managers, is going through a merger wave creating consolidation and ultimately cost savings. The allocation to the services subsector, the highest in the funds history, but it is not a long-term fundamental change in strategy which has seen allocation in the teens. Big pharma, considered safer for risk-averse investors and boosted due to positive innovation announcements, performed well. Medtech, due to significant M&A activity, was the best performing subsector during first half 2016. Biotechs were the big losers (MSCI World Biotech Index down 13.3% in the first half 2016) suffered most as investors shifted to avoid risk. The negative news on Valeant also did not help. The approximately 20% of the portfolio invested in the emerging markets was the best performing sector for Pharma/wHealth during the first half.

The portfolio remains well-diversified with over 200 positions and the top 20 positions comprising 19.7% of total.

The top ten positions, listed by size, saw the following changes during the first half of 2016.

Merck & Co.	
Allergan PLC	
United Health Group Inc.	
Medtronic PLC	
Incyte Corp.	
Bristol-Myers Squibb Co.	
Aspen Pharmacare Holdings PLC	
Biomarin Pharmaceutical Inc.	Added
Eli Lilly & Co.	
Lupin Ltd.	Added
Roche	Deleted
Novartis	Deleted

Volatility over the life of the fund has remained comparable to the volatility of the S&P 500. Sector funds historically have exhibited higher volatility.

Average Market Cap of Portfolio

2016 (June) USD 8.3 billion
2015 USD 11 billion
2014 USD 8.9 billion
2013 USD 5.4 billion
2012 USD 4.9 billion

The reduced average market capitalization in the first half reflects the negative performance and the reduction of the Roche and Novartis positions.

Market Capitalization Segmentations

	2012	**2013**	**2014**	**2015**	**1H 2016**
Large	39%	42%	54%	59%	54%
Mid	32%	28%	21%	17%	20%
Small	29%	30%	25%	24%	26%

Healthcare

The general expectations over the foreseeable future will likely revolve around headlines magnifying actual drug approvals in the fight against cancer and some progress, but no actual results, in the struggle to delay the impact of Alzheimer's.

Immunotherapy, which leverages the human body's immune system to fight cancer, has advanced rapidly and is becoming a very effective tool. The cost of sequencing a genome has fallen from $17.5 million in 2005 to just $1,000 in 2015 (Source: National Human Genome Research Institute – October 2015) resulting in a quantum acceleration of research. The road to approval though remains long and uncertain. About one-third of the about 10,000 Phase 1 clinical trials during the last 10 years have targeted cancer and yet only 5.1% of all of these have ended up receiving FDA approvals. Nearly half of all Phase 3 clinical trials ultimately receive FDA approval, but only about one-third of cancer drugs at that stage receive FDA approval. FDA approval does not necessarily result in commercial success.

Opdiva, developed by Bristol-Myers Squibb, is a good example. Initially approved for Melanoma (skin cancer), it also recently received approval for a segment of lung cancer patients and has shown likely potential with other cancers. Sales quickly reached $3.2 billion in revenues and will grow as additional positive trial results are achieved. Bristol-Myers Squibb spends about $15 billion each year in R&D and currently trades at around 25 times forward earnings.

Gilead, on the other hand, trades at about 7 times estimated 2017 earnings, although it introduced the most successful ever drug which not just suppresses, but in its latest version actually cures all six major strains of hepatitis C. The drug and its latest versions have achieved revenues of over $36 billion in just 3 years. The reason for the big differential in stock valuations reflects a fear that Gilead does not have another drug of similar potential and now faces competition from AbbVie and Merck. Whereas Sovaldi was initially priced at over $120,000 for a full course of treatment, the competition has forced pricing to be now down by nearly 50%. The cost is still prohibitive to most and a major drain to the insurers and the government programs, in real terms, it is cheaper than historical costs of various drugs to suppress the hepatitis C virus for many years followed by liver transplants, lengthy hospitalizations and premature deaths. As an investor comparing Gilead trading at 7x 2017 forward earnings versus Bristol-Myers Squibb at 25x forward earnings, one must look at how Gilead is spending its huge cash flow-considering it recorded $0.55 in net profit on every $1 of revenue. Gilead has spent about $3 billion on R&D and in the first quarter of 2016 alone has spent $8 billion on stock buy-backs. According to a Goldman Sachs study, cheap leverage has created a surge of stock buy-backs which has recently included about three-fifths of all S&P 500 companies. Stock buy-backs make earnings per share look better, sometimes increase management compensation, but typically do not enhance corporate operations and may suggest that management does not see attractive, longer-term accretive options to deploy cash.

The above comments on Bristol-Myers Squibb and Gilead are not indicative of Pharma/wHealth's opinion on specific investments, as we have always refrained from making any recommendations to our investors, but rather an attempt to illustrate the importance of looking forward when investing in healthcare. Longer-term value is created by innovation rather than financial engineering.

The latest FDA approvals have included treatments which combined two or more existing drugs have proven to be powerful tools in the battle against cancer. The pricing of the combination of two already expensive drugs will be a challenge to all involved.

Outlook for 2nd Half 2016

The NASDAQ Biotech Index dropped 20% by mid-February and was down about 40% since July 2015. Although the second quarter was positive, the sector continues to show higher than historical volatility. Emerging Markets healthcare stocks, surprisingly, performed well relative to their peers in the mature markets, even after the Brexit vote. Looking forward, stock selection should take the following factors, negative and positive into consideration.

Negatives

 The US presidential campaign will continue to put pressure on drug company valuations. It appears to us that Secretary Clinton will again attack drug pricing in September and October, but will be rational if elected president. It is impossible to predict Mr. Trump's position, but his business background will hopefully make him rational. Whoever controls Congress will probably be the most important factor.

 Risk-off sentiment will impact biotech and medical device companies more than the bigger pharmas.

 Emerging Markets may experience more volatility, although higher growth rates of demand will continue.

 China continues to lack transparency.

 Drug research failures, including drugs targeting Alzheimer's, will create negative headlines.

 Longer-term pressure to convert pricing to "value-based purchasing" will force drug companies to justify pricing based on outcomes and may create unpredictable pressure on pricing of individual drugs.

 Performance due to M&A for Medtech and Healthcare Services will subside.

Positives

 Drugs have remained at around 10% of total healthcare expenditures in the US in spite of the very high cost of recently introduced hepatitis C and cancer drugs. These drugs are cost effective. A rational approach to cost containment will attack the 90% of the costs, which reflect many antiquated procedures and administration, rather than focus exclusively on drugs.

 The five biggest biotechs trade at 15 times forward earnings down from 24 times in July 2015 according to Fact Set. Biotechs are trading below historical valuations and do not reflect expected growth.

 Drug research, fueled by more than $60 billion a year in the US alone, has reached an inflection point with new, faster and cheaper tools promising an avalanche of important drug approvals. We expect drug approvals in 2016 to be about 60, more than double approvals in 2013.

- Patent protection will provide pricing flexibility for unique life-saving drugs.

- Brexit should not have longer-term impact on the sector as Great Britain accounts for less than 3% of global drug sales.

Pharma/wHealth will continue to invest based on fundamentals rather than follow headlines and use sell-offs as buying opportunities. We continue to look for innovation as the driver of stock performance. As deep research-driven longer-term investors, we do not invest in companies like Valeant, which seek to create short-term performance through financial engineering rather than healthy sustainable business models.
We thank our managers for their continued contribution to make Pharma/wHealth a superior investment vehicle for investors seeking exposure to the healthcare sector.

Sincerely,
The Board of Directors of
Pharma/wHealth Management Company S.A.,
Luxembourg

Opportunities and Risks

Opportunities	Risks
— Price gains on the equity-, fixed income- and commodity markets — Interest and dividend income — Risk management	— Price losses on the equity-, fixed income- and commodity markets — Risk that the borrower is not able to repay the bond at maturity (nominal value) (default risk) which generally results in a decreasing NAV. — The unit value of the fund may be adversely affected – both due to the increase in yields/ decrease in price on the bond markets, as well as redemptions during illiquid market periods. — The solvency of the bond issuer of a directly or indirectly allocated security or money market instrument may decrease after the purchase of the bond. This may result in a decrease of its NAV, which is generally beyond the general market fluctuation (credit risk) — The possible use of derivatives creates counterparty risk (counterparty credit risk). Counterparty credit risk means generally the risk of a possible, temporary or permanent inability to timely fulfill its payment obligations. Derivatives are neither subject to a legal nor voluntary deposit protection — The value of the fund's shares may fall below the price at which the client originally bought them

As of: July 11th, 2016